No. 06-94

FILED
SEP 5 - 2006
OFFICE OF THE CLERK
SUPREME COURT, U.S.

In The
Supreme Court of the United States

FULLER-AUSTIN INSULATION COMPANY, f/b/o FULLER-AUSTIN ASBESTOS SETTLEMENT TRUST,

Petitioner,

v.

HIGHLANDS INSURANCE COMPANY, *et al.*,

Respondents.

On Petition For A Writ Of Certiorari To The California Court Of Appeal, Second Appellate District, Division Two

PETITIONER'S REPLY BRIEF

CHARLES J. COOPER*
MICHAEL W. KIRK
BRIAN S. KOUKOUTCHOS
DEREK L. SHAFFER
COOPER & KIRK, PLLC
555 Eleventh Street, N.W.,
Suite 750
Washington, DC 20004
(202) 220-9600
**Counsel of Record*

Counsel for Petitioner

[Additional Counsel Listed On Inside Cover]

COCKLE LAW BRIEF PRINTING CO (800) 225-6964
OR CALL COLLECT (402) 342-2831

ROBERT M. HORKOVICH
ANDERSON KILL & OLICK, P.C.
1251 Avenue of the Americas
New York, NY 10020
(212) 278-1322

MICHEL Y. HORTON
JASON B. KOMORSKY
MORGAN, LEWIS & BOCKIUS LLP
Twenty-Second Floor
300 South Grand Avenue
Los Angeles, CA 90071
(213) 612-2500

STEVEN A. BUXBAUM
HAYNES AND BOONE, LLP
One Houston Center
1221 McKinney Street, Suite 2100
Houston, TX 77010
(713) 547-2041

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES..... ii

CONCLUSION..... 10

TABLE OF AUTHORITIES

Page

CASES

Amchem Prods., Inc. v. Windsor, 521 U.S. 591 (1997) 4

Cox Broad. Corp. v. Cohn, 420 U.S. 469 (1975) 1, 2, 3

Fuller-Austin Insulation Co. v. Highlands Ins. Co., 38 Cal. Rptr. 3d 716 (Cal. Ct. App. 2006) (No. B170079) 9

Hudson Distribs. v. Eli Lilly & Co., 377 U.S. 386 (1964) 4

In re Armstrong World Indus., No. 00-4471, 2006 U.S. Dist. LEXIS 60561 (D. Del. Aug. 14, 2006) 7

Local 438, Construction & Gen. Laborers' Union v. Curry, 371 U.S. 542 (1963) 4

North Dakota State Bd. of Pharmacy v. Snyder's Drug Stores, 414 U.S. 156 (1973) 3

Ortiz v. Fibreboard Corp., 527 U.S. 815 (1999) 4

Perez v. Campbell, 402 U.S. 637 (1971) 4

Radio Station WOW v. Johnson, 326 U.S. 120 (1945) 4

UNR Industries, Inc. v. Continental Casualty Co., 942 F. 2d 1101 (7th Cir. 1991) 5, 6

OTHER

11 U.S.C. § 524(e) 5

11 U.S.C. § 524(g) ..... *passim*

28 U.S.C. § 1257 3

28 U.S.C. § 1257(a) 1

H. R. Rep. No. 103-835 (1994) 7

PETITIONER'S REPLY BRIEF

Respondents' overheated prose cannot obscure the reality that the California Court of Appeal has struck a crippling blow to Congress' lone legislative response to the Nation's asbestos litigation crisis. The decision below has transformed Section 524(g), enacted to ensure discounting of an asbestos trust's payments to present claimants for the sake of preserving assets for future claimants, into a siphon for diverting assets owing to the trust into the pockets of Respondent insurers. State law has thus been interpreted to starve the federal regime governing asbestos bankruptcies of essential insurance assets. Neither Respondents nor the court below denies that this result subverts the regime Congress enacted specifically to address the asbestos litigation crisis. The decision below warrants the plenary attention of this Court.

1. Respondents object that this Court lacks jurisdiction under 28 U.S.C. § 1257(a) because the state court decision below remanded for further proceedings with respect to some (but not all) of the Respondent insurance companies. Respondents' Brief in Opposition ("Opp.") at 11. But Respondents' "mechanical" notions of finality have been spurned by this Court for two centuries. *Cox Broad. Corp. v. Cohn*, 420 U.S. 469, 477 (1975). As Chief Justice Taney explained, "the Court ha[s] not understood the final-judgment rule 'in this strict and technical sense, but has given [it] a more liberal, and, as we think, a more reasonable construction.'" *Id.* at 480-81 (quoting *Forgay v. Conrad*, 47 U.S. (6 How.) 201, 203 (1848)) (alteration in original).

> There are now at least four categories of such cases in which the Court has treated the decision on the federal issue as a final judgment for purposes of 28 U.S.C. § 1257 and has taken jurisdiction without awaiting the completion of the additional proceedings. . . .

Id. at 477. Of particular import is the category in which "the federal issue would not be mooted or otherwise affected by the proceedings yet to be had because those

proceedings . . . are wholly unrelated to the federal question." *Id.* at 478. Respondents concede that the remand has nothing to do with the federal issue presented here, but will instead involve only a "determination whether the Plan is 'unfair, unreasonable or the product of fraud or collusion'" under State law. Opp. at 11 (quoting App. 45a). Respondents then assert that, "[i]f the trial court determines that it is any of the above, petitioner does not contest that respondents will then have no obligations under their insurance policies arising out of the Plan." Opp. at 11.

In fact, Respondents' assertion is untrue and Petitioner *does* contest it, because the remand applies only to *some* Respondents. There are several Respondents who retain "obligations under their insurance policies" *regardless* how the remand proceedings turn out. Six Respondents have reached settlements with Petitioner under which the *only* dispute remaining is "whether [the insurer] is obligated to indemnify the Trust for the Allowed Liquidated Value . . . of individual claims . . . or the amount the underlying claimants actually receive, *i.e.*, the Allowed Liquidated Value times the Payment Percentage (the 'ALV Issue')."[1]

---

[1] Settlement Agreement Between Fuller-Austin and First State Ins. Co., New England Reinsurance Corp., and Twin City Fire Ins. Co. (collectively "Hartford") at § I.A. The same provision is found in the other two settlements. *See* Settlement Agreement Between Fuller-Austin and TIG Ins. Co. as successor to Int'l Ins. Co. and Int'l Surplus Lines Ins. Co. ("International") at § I.A; Settlement Agreement Between Fuller-Austin and Columbia Casualty Co. and Transcontinental Ins. Co. (collectively "CNA") at § 3.a. Respondents bury the existence and import of one of the three settlements (Hartford's) in a cryptic footnote. Opp. at 11-12 n.8. This is surprising, insofar as Respondent CNA, a signatory to the Opposition, is a party to one such settlement and knows better. Respondents offer as an aside that the excess insurers who have settled "have relatively small exposure to the Fuller-Austin risk." Opp. at 11-12 n.8. Though Respondents may dismiss this exposure as "small," it in fact offers the prospect of millions of dollars in excess coverage for asbestos victims who otherwise stand to receive as little as $15,000 for the most grievous possible condition, mesothelioma,

(Continued on following page)

That is the federal question presented here. These settling Respondents have waived all other rights and defenses, including the "unfair, unreasonable or fraudulent" defense that is the subject of the remand, and have stipulated that they will "not participate at the trial court level unless or until there is a remand on . . . the ALV Issue and then only on th[at] issue[]."[2] Their payment to Petitioner of certain designated insurance proceeds is conditioned exclusively upon Petitioner prevailing in this coverage litigation on the federal issue presented here.[3]

With respect to these six settling Respondents, therefore, the proceedings in the State trial court on remand are irrelevant. Indeed, the settling insurers have stipulated that they will not participate in those remand proceedings, and that the federal issue decided by the state court below and now presented in the Petition is dispositive of their payment obligations.[4] As such, this case falls squarely within one of the well-established exceptions to the Section 1257 finality requirement: "the federal issue, finally decided by the highest court in the State, will survive and require decision regardless of the outcome of future state-court proceedings." *Cox*, 420 U.S. at 480. "Nothing that could happen in the course of the [remand proceeding], short of settlement of the case, would foreclose or make unnecessary decision on the federal question." *Id.* This Court's jurisdiction under Section 1257 is beyond dispute.

---

see infra at 6, and who would hardly deem it inconsequential. In no event, of course, would the magnitude of the coverage at issue bear upon the question of jurisdiction.

[2] Hartford Settlement at § IV.A & B; International Settlement at § IV.A & B; CNA Settlement at § 3.c.

[3] Hartford Settlement at § IV.C & D; International Settlement at § IV.C & D; CNA Settlement at § 3.b. & c. "There is no suggestion that 'the remaining litigation may raise other federal questions.'" *North Dakota State Bd. of Pharmacy v. Snyder's Drug Stores*, 414 U.S. 156, 163 (1973) (quoting *Radio Station WOW v. Johnson*, 326 U.S. 120, 127 (1945)).

[4] The total of these contingent payments is $3,150,000.

Nor do any prudential concerns counsel against this Court's exercise of jurisdiction. The issue of federal law, the ALV issue that six Respondents have cleanly set apart and preserved in their settlement agreements, is presented here in a form that is equally neat and uncluttered. As Justice Frankfurter has explained, even the statutory jurisdictional requirement of finality must be tempered to accommodate "situations where intermediate rulings [by state courts] may carry serious public consequences." *Radio Station WOW v. Johnson*, 326 U.S. 120, 124 (1945). *A fortiori*, prudential concerns must likewise give way to the need to enforce important congressional policies. *See Local 438, Construction & Gen. Laborers' Union v. Curry*, 371 U.S. 542, 550 (1963) ("postponing review would seriously erode . . . national labor policy"); *Hudson Distribs. v. Eli Lilly & Co.*, 377 U.S. 386, 389 & n.4 (1964) (federal antitrust policy). The congressional program for dealing with the national asbestos litigation crisis is threatened by the decision below and warrants the Court's immediate attention, particularly in light of this Court's pointed expressions of alarm. *See Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 821 & n.1 (1999); *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 598 (1997); Pet. at 2.

2. Respondents protest that certiorari is unwarranted because the decision below was based on state law. Opp. 8-9. But that does not distinguish this case from *any* preemption case where a State has derogated federal commands in favor of its own laws. *See Perez v. Campbell*, 402 U.S. 637, 651-52 (1971). The court below *expressly acknowledged* that its decision subverted Section 524(g)'s purpose, which was to ensure equality among and ease the plight of asbestos victims, and that it was doing so for the benefit of insurers, by easing their coverage obligations instead. *See* App. 4a, 56a. Respondents neither deny that subversion nor defend it. Moreover, as both we and our *amici* have explained, federal law necessarily governs and cabins the import of a bankruptcy discharge and attendant discounting of ALV values it contemplates; by distending

those as it has, the court below has run afoul of that law separate and apart from any question of California law.[5]

It is similarly disingenuous for Respondents to deny the conflict between the court below in this case and the Seventh Circuit in *UNR Industries, Inc. v. Continental Casualty Co.*, 942 F.2d 1101 (7th Cir. 1991). It matters not that *UNR* was decided under "Illinois law" whereas the decision below was decided under "California law," Opp. at 15, because the UNR regime is what Congress codified as federal law. *See* Pet. at 5-7. Respondents deny neither that Congress modeled 524(g) on the UNR bankruptcy plan, nor that the bankruptcy plan here is indistinguishable from UNR's in all relevant respects. *See* Pet. at 19-23.

The court below, unlike Respondents, was at least forthright about its reasons for "declin[ing] to follow *UNR Industries*."[6] App. 60a. The California Court of Appeal did not point to any difference between its law and that of Illinois. Nor did it identify any differences between these insurance contracts and those at issue in *UNR*. The decision below pointed solely to the defining feature of this trust as established pursuant to Section 524(g) – namely, the differential between the "[higher] ALV amounts" owed by the trust to asbestos claimants and the lower "payment sum percentage received by each asbestos claimant" in

---

[5] Respondents try to harmonize the decision below with Section 524(g) by claiming that its "sole reference . . . to insurance or insurers is a provision that . . . actually *confers rights upon insurers*." Opp. at 10 n.7. But that is answered by the submission of the *amici* asbestos trusts. The *raison d'etre* of the companion provision, Section 524(e), is to prevent third parties from escaping or reducing their liability on the basis of a bankrupt entity's discharge. *See Amicus* Brief of Babcock & Wilcox Company Asbestos PI Trust, *et al.* ("Am. Br.") at 6-7. That provision thus specifically limits the rights of the *insurers* of a bankrupt policyholder who might otherwise attempt to avail themselves of a discharge to reduce their coverage obligations.

[6] In an empty rhetorical flourish that typifies their Opposition, Respondents claim that this sentence has been "wrenche[d] out of context" by us, Opp. at 15 – without specifying what that context is or how the sentence could be read differently.

order to achieve equity of payouts between present and future claimants. App. 59a-60a. That feature of federal law, and it alone, drives the split between *UNR*, on which Congress modeled Section 524(g), and the decision below, which thwarts the congressional design.

3. According to Respondents, the problem is *not* that Petitioner's assets are inadequate to ensure payment to present and future claimants alike of proper damages for their injuries; instead, it is that the ALVs for those claims, which Respondents dismiss as "notional," are, Respondents say, wildly inflated relative to the Payment Sum Percentages ("PSPs") that Petitioner is actually able to pay. Opp. at 2, 3 n.1. Respondents call the ALV amounts "contrived payment provisions designed to create the appearance of massive liability." Opp. at 2.

That is false. The ALVs that Respondents paint as extravagant are in fact extremely modest: a claimant with mesothelioma – the extraordinarily painful and invariably fatal signature asbestos cancer – would receive but $58,500 if Petitioner were able to pay *all* projected claims *in their entirety*, which it cannot do.[7] Because Petitioner's assets are dwarfed by its asbestos liabilities (taking account of future claims, per 524(g)), claimants will, as Respondents concede, receive only a "fraction" of that amount, Opp. at 5, presently some $15,000 as calculated under the PSP. Given the constraints of policy limits and settlements, the PSP payout would stand to increase only to some $28,000 even under the trial court's ruling in favor of Petitioner.[8] Any fair-minded observer would surely recoil at this paltry compensation for so grievous an injury. But

---

[7] ALVs decline from there: $25,500 for lung cancer; $15,500 for other cancers; $10,500 for asbestosis; and $5,500 for pleural disease.

[8] Although Respondents state that the PSP "is now set at 18.5%," Opp. at 3 n.1, it is in fact set at 26%. This PSP would increase to some 44% of the ALV were Respondents obligated to pay the higher amounts – as nonetheless limited by policy limits and settlements that have been entered – in accordance with the trial court's decision.

only Respondents would complain of the ALV amounts as though they were evidence of collusive *profligacy*.

The very purpose of Section 524(g) was to ameliorate the harsh reality that "asbestos companies [would be] forced into litigation and lose their ability to generate stock value and profits that can be used to satisfy claims," and to afford "reasonable assurance that the trust will value, and be able to pay, similar present and future claims in substantially the same manner." H.R. Rep. No. 103-835, at 41 (1994), App. 271a. The ALV and PSP amounts were determined just as Congress envisioned: through an arms-length negotiation, based on historical settlements and actual litigated outcomes, in connection with the same type of "prepackaged" bankruptcy plan endorsed by Congress (in the form of the Johns-Mansville and UNR bankruptcy trusts) when it enacted Section 524(g).[9]

Despite their bluster, Respondents cannot point to even a *single* difference between the ALV amounts and the standards set by the nation's long history of hundreds of thousands of asbestos claims. Nor can they deny that the PSP discount reflects – just as Congress contemplated – Petitioner's inability to satisfy more than a fraction (the PSP) of the fair value (the ALV) of present and future claims. *That* is the true nature of the asbestos crisis, and it

---

[9] Experts testified at length at the bankruptcy hearing on the *bona fides* of the ALV amounts, which are often lower than those paid by comparable debtors. ALVs were based on aggregate results from *all* cases filed against Petitioner, including those that went to judgment. Statistical modeling endorsed by OSHA, along with mortality statistics, was used to project future claims through 2030. Claims were then broken down into five disease categories. Values for these categories were based on Petitioner's actual payment history, and checked against values assigned to comparable claims in, *e.g.*, the UNR and Johns-Mansville bankruptcies. In sum, there was nothing "notional" about the ALVs, which had nothing to do with crafty lawyers and everything to do with the acknowledged realities of asbestos litigation and the requirements of Section 524(g). *See generally In re Armstrong World Indus.*, No. 00-4471, 2006 U.S. Dist. LEXIS 60561 (D. Del. Aug. 14, 2006) (crediting same experts and approving parallel asbestos plan as comporting with benchmarks).

has been exacerbated by the decision below and obscured by Respondents here.

4. Respondents' objection that they were shut out of the ALV negotiations and the bankruptcy proceedings, Opp. at 2-4, is disingenuous – and foreclosed. The court below expressly held that they "were afforded a reasonable opportunity to participate in the settlement negotiations" but chose instead "to hover in the background of critical settlement negotiations and thereafter resist all responsibility on the basis of lack of consent," which the court would not permit. App. 42a-45a.

5. Respondents' true object is to use Section 524(g) to get themselves off the hook at the expense of asbestos victims whose claims are approved by a reviewing trust. Our *amici* explain how the decision below perversely enables insurers to evade their coverage obligations, in contravention of federal law, simply by virtue of their policyholders' bankruptcies. *See* Am. Br. at 5-9. Respondents are excess insurers whose obligations are triggered by incurred liabilities, not actual payments, that exceed the attachment points specified in their respective policies. *See* App. 5a. Yet Section 524(g)'s central purpose is to ensure that an asbestos trust's other assets are not exhausted until all deserving claimants, present and future, have been paid equally; it requires Petitioner to limit its payouts to present claimants to ensure that future claimants can be paid like amounts for similar injuries. Thus the inevitable effect of Section 524(g), as distorted and applied by the court below, is to relieve excess insurers of their coverage obligations to the extent that the trust's existing assets are husbanded, as required by Congress, rather than actually paid out immediately to beneficiaries whose claims have been allowed by an asbestos trust. Respondents have thus convinced California to disable Section 524(g) trusts from drawing upon insurance coverage such as this for the sake of the beneficiaries, asbestos victims, whom Congress meant to protect.

6. Respondents assert that "no claim was raised in the court below that section 524(g) preempts California

insurance law or abrogates respondents' California-law rights under the policies." Opp. at 9. Nonsense. In its brief below, Petitioner addressed Respondents' contention "that application of 'normal' insurance principles to a § 524g bankruptcy results in total forfeiture of coverage," and argued that this "would eviscerate the very goals of Congress and create an unwarranted windfall for liability insurers." Consolidated Respondent's Brief of Fuller-Austin Insulation Company Addressing the Collective Arguments of All Appellants ("FA Br.") at 2, *Fuller-Austin Insulation Co. v. Highlands Ins. Co.*, 38 Cal. Rptr. 3d 716 (Cal. Ct. App. 2006) (No. B170079); *see also* FA Br. at 2. ("[S]ettled insurance law principles neither encourage nor require the kind of frustration of Congressional purpose sought by the insurers."); FA Br. at 50 ("Because the company does not have enough insurance, the requirements of § 524g force Fuller-Austin to hold back on payments to the earliest claimants in order to assure there will be adequate compensation for later claimants."). There was no occasion there for Petitioner to argue specifically in terms of preemption, for the trial court had created no conflict between California and federal law – only the appellate court did.

Lest there be any doubt that the preemption question is properly posed, the court below expressly acknowledged, per Petitioner's arguments, that the trial court's decision "comports with the goals of 11 U.S.C. section 524(g)" before nonetheless reversing that decision. App. 4a.

7. Respondents also contend that "the petition badly distorts the actual decision below." Opp. at 15. Their folly, if not hypocrisy, is evident from reading the decision itself. Although we are accused of having lifted "a fragment from one sentence of the California Court of Appeal's recital of the *trial court's jury instructions*," with respect to the reasonableness of the ALV amounts as fixed by the bankruptcy court, Opp. at 16, the court of appeals in fact *approved* of those instructions insofar as they "limited the issue of reasonableness *to the ALV amounts*." App. 68a (emphasis added). The court below remanded a different question, one that the bankruptcy court had not addressed

– namely, whether the settlement as a whole, apart from its specific ALV amounts, was unreasonable or collusive. *See* App. 68a-70a. The Petition acknowledges the pendency of that question without seeking certiorari on it. *See* Pet. at 10 n.2, 14.

Respondents also see distortion in our failure to note the holding of the court below that "'the ALV does not reflect Fuller-Austin's legal obligation to each claimant.'" Opp. at 17 (quoting App. 56a). Far from trying to elide that holding, however, the Petition flags it as the gravamen of the Question Presented. Pet. at *i*. Contrary to Respondents' account, this holding has *nothing* to do with the reasonableness of the ALV amounts approved by the bankruptcy court. Instead, the holding was expressly based upon the court's reading of the bankruptcy plan as "permitting the Trust's obligations to be satisfied by payment of the payment sum percentage." App. 58a. Thus, it was based upon misconceptions about how and why an asbestos trust discounts payments below the amount of its actual liability to present claimants in obedience to Section 524(g), which misconceptions the Petition squarely targets, Pet. at 19-24, and the Opposition conspicuously fails to defend.

8. Finally, Respondents claim that the Petition "greatly exaggerates the supposed importance of the decision below." Opp. at 17. The submissions of the *amici* asbestos trusts, embraced by consumer groups, forcefully refute this. A California court has turned Section 524(g) – Congress' lone legislative response to the asbestos crisis to date – on its head, thereby imperiling the statutory regime and the proper operation of any Section 524(g) asbestos trust that depends significantly on insurance assets. Prompt review by this Court would serve the interests of asbestos victims, asbestos defendants, and all others directly involved in the asbestos litigation crisis – save perhaps for these Respondents.

CONCLUSION

The petition for a writ of certiorari should be granted.

September 5, 2006

Respectfully submitted,

ROBERT M. HORKOVICH
ANDERSON KILL & OLICK, P.C.
1251 Avenue of the Americas
New York, NY 10020
(212) 278-1322

MICHEL Y. HORTON
JASON B. KOMORSKY
MORGAN, LEWIS & BOCKIUS LLP
Twenty-Second Floor
300 South Grand Avenue
Los Angeles, CA 90071
(213) 612-2500

STEVEN A. BUXBAUM
HAYNES AND BOONE, LLP
One Houston Center
1221 McKinney Street
Suite 2100
Houston, TX 77010
(713) 547-2041

CHARLES J. COOPER*
MICHAEL W. KIRK
BRIAN S. KOUKOUTCHOS
DEREK L. SHAFFER
COOPER & KIRK, PLLC
555 Eleventh Street, N.W.
Suite 750
Washington, DC 20004
(202) 220-9600

**Counsel of Record*